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UNCLAS SECTION 01 OF 05 ASHGABAT 000729

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SUBJECT: TURKMENISTAN ENERGY: "YOU DON'T HAVE TO BE
GAZPROMISTAN"

REF: A. ASHGABAT 0699
¶B. ASHGABAT 0690
¶C. ASHGABAT 0554

ASHGABAT 00000729 001.4 OF 005

¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: In a lively exchange of views between USDEL and First Deputy Minister of Economy and Finance Jeparov, the U.S. side championed multiple export routes for Turkmenistan,s hydrocarbon resources, explained the economic disadvantage of &selling at the border,8 identified major problems Turkmenistan needs to address to facilitate significant Western investment, and emphasized U.S. interests in Turkmenistan,s energy are strategic.

¶3. (SBU) SUMMARY CON,T: Jeparov admitted Turkmenistan does not fully comprehend how to calculate energy transit costs, evidenced lack of understanding of market forces on national economies, and asked the United States to consider a double taxation treaty with Turkmenistan. However, he showed real openness to U.S. views. This important meeting emphasized the need for us to intensify our efforts to educate Turkmenistani officials about Western models of business and investment. END SUMMARY

¶4. (SBU) SCA PDAS Steve Mann, EUR DAS Matt Bryza, and EEB Rob Garverick met for nearly two hours on July 12 with First Deputy Minister of Economy and Finance Tuwakmamet Jeparov and Chief Specialist Galina Romanova. Both are open-minded and intellectually able young stars of the ministry. Minister Hojimyrat Geldimyradov, who in past meetings has deferred to them, was unavailable, likely because of the on-going

sessions of the Russia-Turkmenistan Joint Economic Commission and concurrent cabinet of ministers meetings.

MAKE IT EASIER ON WESTERN INVESTORS

¶5. (SBU) Mann said the answer to President Berdimuhamedov,s question, &Where,s the new pipeline?8 is another question: &Where,s the gas?8 To convince large Western energy companies to invest in Turkmenistan, they need long-term, stable access to significant hydrocarbon deposits. They also need a positive business environment that supports and facilitates investment. Mann suggested that Turkmenistan needs, for example, to bring its visa regime into compliance with international standard procedures, and allow an international school to operate successfully. Noting that Turkmenistan currently invests $1.5 - 2.0 billion annually in the oil and gas sector, Mann asserted that U.S. estimates suggested that eight to ten times that amount would be needed to achieve Turkmenistan's full export potential.

"NOT BECAUSE WE LOVE YOU -- IT'S HOW MARKETS WORK"

¶6. (SBU) Opening by saying that he was pleased to be in Turkmenistan again, where he first visited almost a decade ago when working on the original Trans-Caspian Pipeline negotiations, DAS Bryza explained that we consider three important relationships when looking at Caspian energy discussions. First is with Turkmenistan, because we are concerned about its prosperity and independence, and want it to receive the fairest, highest prices for its energy resources. Second, the United States maintains important relations with its friends in Europe, both NATO members and others alike. In seeking a fair price for its gas, Bryza explained that Turkmenistan should receive the equivalent of the European price less a fair transit price, net-back

pricing is the most fair, transparent, and efficient way to set pricing. Third, U.S. relations with Russia are important to us. We want fair competition, not confrontation with Russia.

¶7. (SBU) Bryza noted Gazprom does not use transparent net-back principles to set prices for Central Asian gas. While consumers in Europe pay $285 per thousand cubic meters, Turkmenistan receives only $100, which means someone else gets the remaining $185 difference. We want Turkmenistan to receive the highest possible price for its gas, not because we love Turkmenistan or are generous, but because that is how markets work. When markets function efficiently, national security and prosperity are strengthened. If Turkmenistan gains direct access to the European market, Russia will have to pay Turkmenistan more for gas. Noting that Central Asian gas will ultimately find its way to Europe anyway, Bryza stressed that now was the time for Turkmenistan to seek direct access to the European market before Gazprom monopolizes the transit infrastructure.

¶8. (SBU) Bryza recounted that a Central European Prime Minister had recently told him his country wants Central Asian gas, but Azerbaijan told this Prime Minister it had no available quantities, and Russia told him that it had "bought all Turkmenistan's gas forever." Acknowledging Turkmenistan's requests for concrete proposals for new pipelines, Bryza repeated PDAS Mann's assertion that this will happen only when Western companies see the advantage of investing in Turkmenistan. Bryza assured Jeparov that when this happens, we will use all of our diplomatic influence in Europe and the Caucasus to make it possible for Turkmenistan to receive the highest possible price for its gas. This is part of our strategic vision for international relations.

IS A TRANS-CASPIAN PIPELINE TOO EXPENSIVE, "GRANDIOSE"?

¶9. (SBU) Jeparov noted that in gas policy, President Berdimuhammedov is committed to continue former President

Niyazov,s diversification policies. China's agreement to construct a gas pipeline already represented an alternative route, and a Trans-Afghanistan Pipeline could provide significant transit revenues for that country. A Trans-Caspian Pipeline to Europe via Turkey could be realized, but Jeparov asked what concretely constitutes energy security for Europe.

¶10. (SBU) Jeparov commented that while there was currently no direct pipeline from Central Asia to Europe, the Trans-Caspian proposal was perhaps a &grandiose8 project that was more expensive than existing arrangements. Not true! interjected both Mann and Bryza. Jeparov said Turkmenistan currently receives (from Gazprom) $100 per thousand cubic meters at the border, and it is difficult to calculate what appropriate transit fees should be. He agreed that monopolist transport was economically inefficient, but Russia offers guaranteed market access that Jeparov suggested actually supported European security, because this gas ensures uninterrupted Russian supply to European consumers. Additionally, he noted Turkmenistan's large potential gas reserves in the South Yoloten field and the recently announced new oil field in western part of the country (NOTE: Presumably the Akpatlawuk field. END NOTE), both of which could allow for multiple export routes in the future.

¶11. (SBU) To attract Western energy majors to Turkmenistan, Jeparov agreed that the business climate was important, but

he wondered exactly what this term meant. If it referred to the legal base, Soviet-era laws already existed. He added that earlier offers by Turkmenistan to address the gaps between U.S. and Turkmenistani legislation had not been met with enthusiasm. For example, the United States had never followed up on the need for a double taxation treaty for U.S. firms operating in Turkmenistan. He asked what other specific gaps might exist and how they might be specifically addressed. Jeparov explained that previous potential foreign investors considering new projects in the Caspian region had offered draft laws providing guidance for specific necessary changes in legislation, which became the basis for Turkmenistan's current law on hydrocarbons.

OTHER AREAS FOR WESTERN INVESTMENT

¶12. (SBU) Jeparov listed other sectors where Western investment would be welcome: upgrading electricity generation and the Soviet-era electrical grid, renovating and modernizing existing factories, liquefied natural gas production, chemical industries related to natural gas production, and agricultural fertilizers for domestic use and export. However, Jeparov said his ministry could not help improve the visa regime, since that is the Ministry of Foreign Affairs, responsibility. (COMMENT: In fact, the Ministry of National Security (ex-KGB) ultimately controls Turkmenistan's visa policy. END COMMENT.)

SOMEONE WILL PAY FOR GAZPROM'S FAILURE TO INVEST

¶13. (SBU) Addressing transit costs, DAS Bryza stressed that we want Turkmenistan to fulfill its contractual obligations to Russia, but both we and Europe want diversification. European policymakers are concerned about the commercial pressures of relying on a sole supplier. Furthermore, they view Gazprom as less and less able to meet its own contractual obligations. According to the International Energy Agency, after 2010, Gazprom may not be able to meet its commitments, because it hasn't invested in upstream production and pipeline infrastructure. Reductions in deliveries over the last two years to Estonia, Lithuania, and Italy emphasize this point.

¶14. (SBU) Infrastructure investments must be made, Bryza stressed, and someone will have to pay for them. First,

consumers will pay with higher prices. But producers will also suffer because Russia will capture the price increases. Turkmenistan needs export options to ensure that it receives the full price for its gas. Bryza showed Jeparov a map and table of projected shipping costs prepared by the France-based Mediterranean Energy Observatory that projects shipping costs for gas to Austria via the Nabucco Pipeline at $2.05 per one million British thermal units (BTU) for Azerbaijani gas, and $2.12 for gas from Turkmenistan, versus $2.90 for the same Turkmenistani gas via Russia. Gas from a Trans-Caspian route would be cheaper, and producers would receive the full price less a transit fee. Furthermore, with the advantage of higher prices through non-Russian routes, Turkmenistan could negotiate for a fairer, higher price for its gas with Russia.

¶15. (SBU) Jeparov fully agreed with Bryza's overall point, but questioned whether the study accounted for the existing Soviet-era infrastructure. Bryza confirmed that the projected costs of existing and upgraded current pipelines through 2020 were factored in. PDAS Mann stressed that

Jeparov had identified the key point, specifically the financial structure of pipelines. A pipeline is more than just pipes, he said. Due to their different financial structures, one could not compare export routes without discussing the accompanying financial structures.

MANN INTRODUCES INTERNATIONAL PRICING FORMULAS

¶16. (SBU) Gazprom's current advantage is that its infrastructure already exists, Mann acknowledged, but it needs billions in new investment. As a result, Gazprom must negotiate new terms every one to three years with its suppliers and consumers. The rest of the world doesn,t work like that, and instead signs long-term gas sales agreements. For example, parties in the Shah Deniz project in Azerbaijan agreed on a gas sales formula based on several factors that adjusted prices daily over its twenty year life. The advantage of such an approach for both parties is stability and a transparent market price. If the global price increases, Mann continued, the seller receives more revenue. The most important part of this arrangement, however, is that it is stable and internationally recognized. If in three years -- or tomorrow -- Gazprom changes the price it pays, Turkmenistan could do nothing because it has no alternative route to market. We want to promote alternate pipelines to Europe for Turkmenistan, but Western investors must have reliable long-term sources of gas.

"SOVIET LEGACY IS HISTORY, BUT DOESN,T HAVE TO BE YOUR FUTURE"

¶17. (U) Mann stated frankly potential Western investors still see Turkmenistan's business climate as very Soviet, which is understandable because that is part of Turkmenistan's history. He stressed, however, it does not have to be part of Turkmenistan's future. We are prepared to support the development of a new private sector in Turkmenistan that benefits Turkmenistan's businesspeople. The current visa regime and requirement for letters of invitation reflect the heavy hand of security control on business, which was understandable in the past. But no business-friendly country in the world has such requirements. This really should be changed. Jeparov said his ministry was ready to discuss all issues, except visas, which is beyond their competence.

"WHAT IS YOUR INTEREST IN TURKMENISTAN'S GAS TO EUROPE?"

¶18. (SBU) Jeparov asked bluntly, "What is the U.S. financial interest in seeing Turkmenistan sell its gas to Europe?" Bryza replied clearly, "We have no financial interest. Our interests are strategic." Europe is our most important trading partner. If Europe is financially

disadvantaged, we are, too. When Europe worries about Russian gas disruptions, as had happened recently to Georgia, Ukraine, and Belarus, it was more difficult to stand together against Russia, the world's largest oil exporter. Equal relations with Russia, which had the world's largest gas reserves, were needed. Our European allies need energy. Gazprom will only grow stronger if it monopolizes the European market and infrastructure.

¶19. (SBU) After a detailed discussion of the advantages of the private sector in a global market economy, Mann recounted his last conversation with Turkmenistan's former President Niyazov in August 2006. Objecting to Mann's assertion that Moscow seemed to view Turkmenistan as "Gazpromistan," Niyazov

admitted that Turkmenistan had no alternatives. Mann stated again our strategic interest is that Turkmenistan finally realizes its full sovereignty and independence. A Trans-Caspian Pipeline is a means to that end.

COMMENT

¶20. (SBU) Jeparov was clear Turkmenistan remains open to the concept of a Trans-Caspian Pipeline but understands very little about the basic needs of Western investors and how the global economy works. One of the most important things we can do is provide a steady stream of essential printed information for broad dissemination throughout the government of Turkmenistan. END
COMMENT.

¶21. (U) PDAS Mann has cleared this cable.
HOAGLAND